

Message Text

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ACTION EUR-12

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PASS: CEA, TREAS, FRB

E.O. 11652: N/A
TAGS: OECD, ECON
SUBJECT: ECONOMIC AND DEVELOPMENT REVIEW COMMITTEE
(EDRC) REVIEW OF NEW ZEALAND

REF: EDR(77)17

1. SUMMARY: AT JUNE 20 EDRC REVIEW OF NEW ZEALAND,
GNZ DELS (LED BY MARTIN, TREASURY) AGREED WITH SECRE-
TARIAT'S VIEW THAT OUTLOOK IN SHORT-RUN WAS FOR LITTLE
OR NO GROWTH, HIGH INFLATION AND MINIMAL SHRINKAGE OF
SUBSTANTIAL CURRENT ACCOUNT DEFICIT. THEY EXPRESSED
DETERMINATION TO PURSUE TIGHT MONETARY AND FISCAL POLI-
CIES IN SHORT-RUN TO HELP REDRESS SITUATION AND OBJECTED
(AS DID EDRC) TO IMPLICATION THAT RESTRICTIVE FISCAL
POLICY HAD BEEN IMPORTANTLY RESPONSIBLE FOR LENGTH AND
DEPTH OF RECESSION. SECRETARIAT ACKNOWLEDGED THAT SUCH
AN IMPLICATION WAS INAPPROPRIATE AND WILL MAKE APPRO-
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PRIATE CHANGES IN REVISED DRAFT SURVEY. LIKE SECRE-
TARIAT, NZ DELS STRESSED NECESSITY AND DIFFICULTY OF
REDUCING CURRENT ACCOUNT DEFICIT TO SUSTAINABLE PROPOR-
TIONS OVER MEDIUM TERM. UNLIKE SECRETARIAT, HOWEVER,
THEY FELT THAT SELECTIVE RATHER THAN GENERAL MEASURES
(E.G., DEVALUATION) TO STIMULATE EXPORTS AND REDUCE
IMPORTS WOULD BE MOST EFFECTIVE IN ACHIEVING THIS RESULT.

MOREOVER, THEY TOOK ISSUE WITH SECRETARIAT VIEW THAT "EXPENDITURE SWITCHING" AS OPPOSED TO "EXPENDITURE REDUCTION" WOULD BE FEASIBLE ADJUSTMENT PATH, EMPHASIZING THAT THESE TYPES OF MEASURES SHOULD BE SEEN AS COMPLEMENTARY, RATHER THAN AS ALTERNATIVES. NZ AND SECRETARIAT NOTED POINTEDLY THAT ABILITY TO ADJUST EXTERNALLY WOULD DEPEND IMPORTANTLY ON TRADE POLICIES OF OTHER OECD COUNTRIES. END SUMMARY

2. SHORT-TERM PROSPECTS; DOMESTIC FOR 1977:

NZ REPS GENERALLY AGREED WITH SECRETARIAT VIEW THAT 1977 WOULD BE A YEAR OF LITTLE OR NO GDP GROWTH AND OF CONTINUED HIGH INFLATION. THEY NOTED THAT ACCORDING TO LATEST FORECAST OF NATIONAL INSTITUTE FOR ECONOMIC RESEARCH, GDP WOULD STAGNATE THIS YEAR AND DOMESTIC DEMAND WOULD DECLINE BY 1 PERCENT. MARTIN CHARACTERIZED THIS FORECAST AS SOMEWHAT PESSIMISTIC, BUT NOT OVERLY SO.

3. DISMAL GROWTH OUTLOOK EXPECTED TO BE ACCOMPANIED BY CONTINUATION OF HIGH INFLATION. GNZ FORECASTS 12-13 PERCENT AVERAGE RISE IN CONSUMER PRICES IN 1977 COMPARED WITH PRESENT 13.5 PERCENT ANNUAL RATE OF INCREASE AND SECRETARIAT FORECAST OF 13 PERCENT. NZ DELS STRESSED THAT OUTCOME (HIGHLY UNCERTAIN) OF WAGE NEGOTIATIONS NOW IN PROGRESS WOULD BE CRUCIAL FACTOR DETERMINING LIMITED OFFICIAL USE

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FUTURE COURSE OF PRICES. THEY DID NOT HAZARD A GUESS AS TO WHAT THE OUTCOME MIGHT BE. NZ REPS POINTED OUT THAT CONTINUED GOVERNMENT INTERVENTION IN PROCESS OF WAGE FORMATION WOULD BE ESSENTIAL TO SECURE FURTHER PROGRESS TOWARD PRICE STABILITY; TIME WAS NOT RIGHT TO MOVE IN DIRECTION OF FREE COLLECTIVE BARGAINING. THEY FELT THAT OFFERING TAX CONCESSIONS ACROSS-THE-BOARD TO INDUCE WAGE MODERATION (A TACTIC USED TWO YEARS AGO) WAS NO LONGER A VIABLE OPTION, BUT INDICATED THAT TAX CHANGES WHICH ALTERED DISTRIBUTION OF INCOME MIGHT BE EFFECTIVE IN DEALING WITH THORNY PROBLEM OF INTER-SECTORAL WAGE DIFFERENTIALS.

4. SECRETARIAT REMARKED THAT MEASURED UNEMPLOYMENT RATE (1.1 PERCENT) UNDERSTATED DEGREE OF SLACK IN LABOR MARKET AND CITED ESTIMATES OF NZ RESERVE BANK WHICH PLACED "POTENTIAL" UNEMPLOYMENT RATE AT 4-4.5 PERCENT. RESERVE BANK GOVERNOR, WHITE, NOTED UNCERTAINTY SURROUNDING SUCH ESTIMATES, BUT AGREED THAT ACTUAL UNEMPLOYMENT RATE WAS SUBSTANTIALLY ABOVE MEASURED RATE. LATTER WAS DRIVEN DOWN BY REDUCTION IN FEMALE PARTICIPATION RATES (DUE TO

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DEPRESSED EMPLOYMENT PROSPECTS) AND BY SHIFT TOWARD NET
EMIGRATION. NEVERTHELESS, SECRETARIAT, NZ AND EDRC
AGREED THAT LOW LEVEL OF "OPEN" UNEMPLOYMENT RENDERED
BITTER MEDICINE ADMINISTERED FOR PURPOSES OF ADJUSTMENT
MORE PALATABLE POLITICALLY.

5. CURRENT ACCOUNT: NZ DELS UNDERLINED FACT THAT CUMU-
LATIVE CURRENT ACCOUNT DEFICIT BETWEEN 1974 AND 1976
CAME TO NZ\$4.0 BILLION AND CITED THIS FIGURE AS PARTIAL
EVIDENCE THAT SMALL OECD COUNTRIES, PARTICULARLY NZ,
WERE SHOULDERING MAIN BURDEN OF OECD AREA CURRENT ACCOUNT
DEFICIT. THEY INDICATED THAT DEFICIT WAS LIKELY TO
INCREASE IN CY1977 AND, WHILE NOT PRESENTING SPECIFIC
FORECAST, DID NOT QUIBBLE WITH SECRETARIAT'S FIGURE OF
NZ\$1.0 BILLION. NZ DID NOT FORESEE OCCURENCE OF EXTERNAL
FINANCING PROBLEMS IN SHORT-RUN AND EXPRESSED VIEW THAT
PRIVATE CAPITAL INFLOWS SHOULD RISE, DESPITE GNZ'S
SCHIZOPHRENIC ATTITUDE TOWARD FOREIGN DIRECT INVESTMENT
AND RELUCTANCE OF FIRMS (DUE TO EXCHANGE RISK) TO BORROW
ABROAD.

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6. NZ DELS EMPHATICALLY AGREED THAT CURRENT ACCOUNT DEFICIT OF PRESENT PROPORTIONS WAS UNSUSTAINABLE OVER MEDIUM TERM (NZ TENTATIVELY DEFINED "SUSTAINABLE" AS CURRENT ACCOUNT DEFICIT OF 2 PERCENT OF GDP), AND THAT REDRESSMENT OF EXTERNAL SITUATION WAS OF HIGHEST PRIORITY. HOWEVER, THEY TOOK ISSUE WITH SECRETARIAT RECOMMENDATION THAT GNZ POLICIES SHOULD (A) FOCUS ON GENERAL, RATHER THAN SELECTIVE, MEASURES TO INCREASE EXPORTS AND REDUCE IMPORTS AND (B) EMPHASIZE "EXPENDITURE SWITCHING" (E.G., MEASURES SUCH AS DEVALUATION, TO INCREASE RELATIVE PROFITABILITY OF EXPORT PRODUCTION), AS OPPOSED TO "EXPENDITURE REDUCTION" (E.G., DEFLATION). CONCERNING (A) ABOVE, SECRETARIAT ARGUED THAT GIVEN DIFFICULTY OF DETERMINING ACTIVITIES (OUTSIDE OF AGRICULTURE) IN WHICH NZ HAD COMPARATIVE ADVANTAGE, NZ SHOULD ACT GENERALLY TO STIMULATE EXPORTS AND LET MARKET DO THE REST. NZ COUNTERED THAT POLICIES TO "NUDGE MARKET IN THE RIGHT DIRECTION" WOULD BE MORE EFFECTIVE.

7. NZ AND EDRC DELS COMMENTED THAT POLICIES OF EXPENDITURE SWITCHING AND EXPENDITURE REDUCTION SHOULD NOT BE VIEWED AS ALTERNATIVES SINCE RESTRAINT OF DEMAND WAS NECESSARY TO FACILITATE NECESSARY SHIFT OF RESOURCES INTO EXPORT SECTOR INITIATED BY CHANGES IN RELATIVE PRICES. NZ REPS ALSO DOUBTED WHETHER EXCHANGE RATE CHANGES WOULD HAVE FAVORABLE EFFECTS ON CURRENT ACCOUNT POSITION IN SHORT RUN. DUE TO LOW PRICE ELASTICITY OF IMPORTS, THEY ARGUED, IMMEDIATE EFFECT OF DEVALUATION WOULD BE TO INCREASE DEFICIT -- A DEVELOPMENT THEY COULD NOT TOLERATE IN PRESENT CIRCUMSTANCES. MOREOVER, SINCE DEVALUATION WOULD HAVE BEEN INCOME DISTRIBUTION, SUCH A MEASURE WOULD HAVE TO BE TAKEN WITHIN LIMITED OFFICIAL USE

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OVERALL CONTEXT NZ'S INCOMES POLICY. THEY REMARKED THAT THERE WAS ROOM FOR DOUBT ON ECONOMICS OF DEVALUATION, BUT NO ROOM FOR DOUBT CONCERNING THE POLITICAL DIFFICULTY OF SUCH A MOVE.

8. FISCAL AND MONETARY POLICY: EDRC SUPPORTED NZ COMPLAINT THAT SECRETARIAT APPEARED TO BLAME GNZ'S RESTRICTIVE FISCAL POLICY FOR CURRENT RECESSION, WHEN IN FACT POSSIBILITY OF EXTERNAL ADJUSTMENT OVER MEDIUM TERM WOULD HAVE BEEN SEVERELY COMPROMISED HAD FISCAL POLICY STANCE BEEN MORE EXPANSIONARY. SECRETARIAT QUICKLY BACKED OFF AND AGREED TO REVISE DRAFT SURVEY IN ACCORDANCE WITH EDRC CONSENSUS. NZ EXPRESSED INTEN-

TION OF CONTINUING RESTRICTIVE FISCAL AND MONETARY POLICIES IN SHORT RUN.

9. IN PRESENTING REFDOC SCENARIO FOR NZ CURRENT ACCOUNT ADJUSTMENT OVER MEDIUM TERM, SECRETARIAT NOTED THAT CERTAIN ASSUMPTIONS CONCERNING EXTERNAL ENVIRONMENT MIGHT BE OPTIMISTIC AND THAT IF THIS WERE THE CASE, NZ WOULD HAVE TO FACE EXTREMELY SERIOUS PROBLEMS. KEY ASSUMPTION, CHARACTERIZED AS OPTIMISTIC, WAS THAT TRADE POLICIES (PARTICULARLY AS REGARDS AGRICULTURAL TRADE) OF NZ'S PARTNERS WOULD NOT BECOME MORE PROTECTIONIST. THUS, EDRC MEETING TERMINATED ON NOTE OF PESSIMISM.
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